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	INR-00	IO-00	ITC-01	LAB-01	L-00	CDC-00	VCIE-00
	DCP-00	NRC-00	NSAE-00	ISN-00	NSCE-00	OES-00	OMB-00
	NIMA-00	PM-00	GIWI-00	ISNE-00	DOHS-00	FMPC-00	SP-00
	IRM-00	SSO-00	SS-00	STR-00	NCTC-00	BBG-00	EPAE-00
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E.O. 12958: DECL: 09/15/2019  
 TAGS: [ENRG](#) [EPET](#) [ECON](#) [AJ](#)  
 SUBJECT: RWE AND OMV CONTINUE TO PROMOTE NABUCCO PIPELINE

REF: BAKU 754

Classified By: Charge Don Lu  
 Reasons 1.4 (B,D, E)

¶1. (C) SUMMARY: Senior Advisor to the Eurasian Energy Envoy Dan Stein met with Nabucco promoters RWE and OMV in Baku. Both remain bullish on the prospects for the Nabucco Pipeline, but admit the project must move ahead within the next year or face eclipse by competing projects such as the ITGI (Italy Turkey Greece Interconnector). Both emphasized Nabucco's strategic importance to Azerbaijan and Europe, and commercial benefits from tapping into the main European gas markets in central Europe, rather than limiting Azerbaijani gas to markets in southeastern Europe. One key difference emerged between the firms - to complement the initial 7bcm of gas expected from Azerbaijan, RWE is banking on gas from Turkmenistan, while OMV is looking to the gas from northern Iraq. This cable is the second in a series. End Summary.

RWE Meeting in Baku  
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¶2. (SBU) Senior Advisor to the Eurasian Energy Envoy Dan Stein, Charge D'Affaires Don Lu, Pol/Econ Chief Garverick, and Energy Off met on September 15 with a delegation from German energy firm RWE: David Skeels, General Manager; Jeremy Ellis, Head of Business Development; Dr. Wolfgang Peters, Head of Supplies for Caspian, Central Asia, and Russia; and Ilham Akbarov, Head of Caspian Region Gas Supply.

Financial Basics of Nabucco  
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¶3. (C) Skeels outlined the basics of the Nabucco Pipeline and the associated development of Azerbaijan's Shah Deniz II gas field from RWE's perspective:

--Shah Deniz II and Nabucco financial commitments - The final investment decision (FID) for SD II will involve a commitment of 20 billion USD for the gas field, and an additional 8 billion Euros for the Nabucco pipeline. Over 25 years of Nabucco operations, he estimates a total nominal value of 200

billion Euros.

--Gas Market - While gas markets are lagging now due the global economic recession, RWE predicts renewed demand for gas to be back up well before 2013 or 2014, the earliest possible the Shah Deniz II gas might come on-line. (Note: This appears to be an overly optimistic view of when SD II gas would be available, since both SOCAR and BP estimate first gas no earlier than 2016. End note.) Skeels pointed to the 500 bcm annual demand in Europe, and continued organic growth in the market.

#### Political Optics of Nabucco Improve

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14. (C) Business Development Head Jeremy Ellis expressed RWE's appreciation for USG support of the Nabucco project, and optimism over the recent appointment of former German foreign minister Joscha Fischer as political communications advisor to the project. He noted "the temperature is being raised after the signing of the IGA." Skeels also noted that RWE's presence has given the Nabucco project additional credibility in Europe.

#### Gas Prospects on Turkmenistan: Berdimuhamedov "Serious"

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15. (C) Skeels outlined progress on obtaining additional gas supplies for Nabucco from Turkmenistan. He explained, "Now we're waiting, pushing for supply." On the issue of securing gas supply for Nabucco from Turkmenistan, Skeels remarked, "(Turkmen President) Berdimuhamedov is serious, but that could change quickly." He mentioned RWE is exploring possible transit exit routes from Turkmenistan. Senior Advisor Stein noted there was only one route the USG would support. Skeels clarified that RWE "was not engaging" on a possible Iran exit route. Stein noted some were beginning to wonder if Berdimuhamedov's efforts were primarily directed to enhancing Turkmenistan's leverage with Russia.

#### Turkmen and Russian Gas Relations Evolve; Turkmenistan Becomes more Sophisticated Negotiator

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16. (C) On the question of Turkmenistan gas sales to Russia, Skeels predicted that Russia would receive lesser volumes of gas for a higher price, as Turkmenistan sought to diversify its gas customers. He added that in the process of negotiating with possible new customers, the Turkmen were finally realizing how badly they had been misled by the Russians. He pointed to Russian abuse of take or pay contract provisions, and "allowing pipelines to go bust," referring to the April explosion of Turkmenistan's gas pipeline to Russia, which some industry observers blame on Gazprom. Skeels surmised that the "the Turkmen are knowledgeable," implying the Russians are now underestimating the Turkmen's evolving understanding of international gas markets.

#### RWE Confident of Turkmen Gas Supply to Nabucco

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17. (C) Skeels expressed optimism on Turkmen gas supply for Nabucco, stating, "We are confident Turkmenistan can deliver 10-15 bcm by 2015 or 2016," and saying most would come from offshore. He also indicated that the Malaysians (Petronas) could become an important part of the Turkmen gas extraction project, indicating RWE was engaged in some discussions with Petronas under the Turkmen umbrella.

#### RWE Downplays Turkmen-Azeri Dispute on ACG

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18. (C) Skeels then turned to the issue of the on-going dispute between Azerbaijan and Turkmenistan regarding ownership of the disputed ACG fields in the Caspian. Skeels stated that if Azerbaijan and Turkmenistan agree to build a

Transcaspian (TCP) pipeline, Turkmenistan's bid for arbitration would not be an issue. Senior Advisor Stein expressed skepticism, stating that based on USG discussions, Turkmenistan was unwilling to entertain building a pipeline until there is some progress on resolving the dispute. He added that Turkmenistan has told us they would not even consider a feasibility study for an interconnector, connecting Block 1 (the Petronas block) with Azerbaijan's gas infrastructure, until the dispute is resolved. Still, Skeels concluded, "In the end, it all comes back to Nabucco, no one will build the TCP without that."

The Battle for Nabucco -  
Turkey Needs to Hear from the EU  
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¶9. (C) Turning to the issue of Turkish support for Nabucco, Skeels pointed out that, "The battle for Nabucco will be won or lost in Ankara." Closely tracking the Azerbaijani view, he stated, "We continually hear from President Aliyev, 'The US is here, where are the Europeans?' The EU is very supportive in words, but not in actions. It could prove its standing vis a vis the IGA," he concluded. Stein concurred, noting EU support is not felt in either Ankara or Baku. Skeels fretted that the EU serves so many interests, "its target frequently gets lost."

Caspian Development Corporation  
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¶10. (C) Regarding the EU's proposal to create a Caspian Development Corporation (CDC), "an interface between European buyers and Caspian and Central Asian producers of gas," Skeels opined, "It would be 3 years down the road, even if they get agreement, and by then, the opportunity will be gone." Stein agreed, noting that many, particularly U.S. oil companies, find the effort "misplaced and misguided," but noted the USG was also pleased the EU was at least attempting to engage on Southern Corridor gas. He explained the USG had agreed to support the feasibility study. Stein also noted a number of U.S. oil companies had expressed concern the CDC would be viewed as an EU-creation, and would therefore inherently disadvantage U.S. companies in Turkmen eyes.

RWE Heralds its "Bold Proposal"

to Underwrite Caspian Gas Sales  
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¶11. (C) To counter what it sees as a cumbersome EU-backed CDC "buying club," RWE told us it has offered to play the role as a underwriter for a single-buyer approach. Skeels stated RWE had offered to release gas in a tender process with a tight deadline, with the agreement of the producers. Skeels claimed RWE would not be established as a middleman like BOTAS proposes, presumably because RWE would not assume legal ownership of the gas. The buyer and seller would enter into a bilateral agreement, and RWE would release the agreed-upon volume. Skeels claimed that RWE was willing to take on additional risk to secure the Nabucco project, pre-empt the CDC proposal, and "break the chicken and egg conundrum." Skeels praised the RWE proposal as a "bold concept," which would allow for a quick FID for Nabucco.

RWE Pushes to Market Nabucco Gas in Western Europe:  
"Higher Gas Prices Compensate for Higher Transit"  
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¶12. (C) Where to market various portions of Nabucco gas is an issue which remains in play. Stein queried about the Turkish transit fee and gas offtake issues which have bedeviled Nabucco. Skeels outlined a couple of different options for allowing offtake of gas, and noted that, whatever gas goes into Turkey, "Turkey wants both gas to play with in Turkey (e.g., to sell into its domestic market) and gas to sell into Europe."

¶13. (C) BD Head Ellis explained the RWE preference for the

Azerbaijani gas to be marketed in the main western European market, and outlined RWE's willingness to walk away from the project if this cannot be sufficiently accommodated. He stated, "We're not going to invest without a link into our home (German) market. There are consequences if they make the wrong decision." On the other hand, he explained, the Azerbaijani point of view is, "if I want to drop off volumes in the Turkish market, I can."

¶14. (C) Senior Advisor Stein queried, "Why not sell gas to the closer markets, e.g., Bulgaria, Romania, and Greece?" Skeel argued they were not in the heartland of European price markets, saying Bulgaria is at most a 4 bcm (billion cubic meters per year) market, Greece 2 bcm, and Italy, while a large market, is already oversupplied with gas. Skeels stated, "SOCAR's misconception is that supplying gas to Bulgaria will give them a higher netback, so why go all the way to Baumgarten (Nabucco's terminus)?" Skeels argued instead that the gas would fetch a much higher price in the German market than the Bulgarian, and this would more than make up for the increased transit costs. Stein countered that taking the gas to Baumgarten did not imply Azerbaijani gas would all be sold at German market prices. Skeels disagreed, stating that at least 50% of Nabucco gas would end up in Baumgarten - being sold for full European market price. Finally, reverting to the question of Azerbaijan's strategic goals, he queried, "whose favor did the Azerbaijanis wish to curry?," implying the western European market would prove strategically more important for Azerbaijan in the future.

RWE Admits ITGI Politically Easier Project  
but RWE Remains Bullish on Nabucco  
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¶15. (C) BD Head Ellis admitted that it was an easier decision for Azerbaijan to go with ITGI instead of Nabucco. "It hits the Russian agenda, it hits all the agendas - apart from Europe's." He stated that Azerbaijani President Aliyev wants to do Nabucco, but needs the Turkish (pricing) situation to be resolved on Shah Deniz I and II. Stein also noted that reconciliation discussions between Turkey and Armenia might make it difficult for Azerbaijan to make a decision for the next few months. Still, Ellis concluded, "We're a lot more optimistic than 18 months ago, RWE is in, it's a big difference to the overall picture (for Nabucco)." The RWE team also offered to run workshops for Azerbaijani or American or policymakers to clarify the Nabucco project economics.

OMV Meeting  
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¶16. (SBU) On 15 September, Senior Advisor Stein and Energy Off also met with Austrian energy firm (and Nabucco partner) OMV representatives Werner Auli, Executive Board member; Wolfgang Sporer, Country Manager, Caspian Region; and Reinhard Mitchek, MD, Nabucco Gas Pipeline.

OMV Remains Bullish as Well  
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¶17. (C) Auli optimistically described the commercial viability of Nabucco, noting, "The financing looks good, the market looks good." He underscored OMV's fundamental view - "With a stable outlet to the European market, money will be invested." Nonetheless, he admitted, "If Azerbaijan decides ITGI has better returns, then Nabucco is dead. But everyone will think hard before giving (Azerbaijan) a second look (in the future.)" Auli critiqued the US backing for the Southern Corridor concept, stating, "two projects (i.e., both Nabucco and ITGI) means no project."

OMV Looks to Iraq as Second Nabucco Supplier;  
Hopes for a Break within a Year  
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¶18. (C) Azerbaijani Shah Deniz II gas would provide the

first 7bcm of gas for the Nabucco. OMV told us it was banking on Iraqi gas to complete Nabucco's supply, although Turkmen gas was also a possibility. OMV executives appeared remarkably sanguine on the prospects for Iraqi gas coming to market soon. Remarking on the status of gas negotiations in Iraq, Auli noted the Kurdistan Regional government (KRG) and Iraqi central government have had 5 years to sort out their issues. "The only remaining issue is profit distribution - but it is a big issue." Auli commented, "We can't spend \$8 billion Euros without a supplier, we need to make it happen next year." Musing about the problems with Turkish and Iranian gas reliability, Auli concluded, "so we always come back to Azerbaijan and Iraq." He added that OMV did not oppose Russian participation. (Note: OMV recently sold 30% of its shares in its Baumgarten gas hub to Russian Gazprom. End note.)

#### Europe Needs more Gas, Alternatives not Feasible OMV Gives Project One More Year

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¶19. (C) Auli expressed some frustration with nations backing Nabucco, stating, "Nabucco is not new, 7 years we have discussed it. In Europe now, coal is not popular, nuclear is disputed, LNG could also be blocked. Europe needs gas. We also need a good balance between LNG and piped gas. Next year - we need to make a decision. If Nabucco is not in place, everyone will deliver to the Turks, and Shah Deniz II won't happen." He added, "Europe needs gas-fired power plants, OMV is now building two, and maybe a third in Germany." Auli complained about the state of European pipelines, noting that Belarus and Ukraine recently had to reduce pressure (and hence capacity) in their 40-year old gas pipeline. Europe, Auli concluded, needs both North Stream and Nabucco.

#### Looking to Gas Markets OMV Targets Large European Markets

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¶20. (C) Echoing comments from RWE, Auli explained the options for marketing Nabucco gas, stating, "Turkey is a nice market with good netback. The Bulgarian market is small, you need Germany, France, and Italy." Comparing Nabucco to ITGI, Auli explained, "Nabucco is a different concept from ITGI, it offers third party access, we can offer 50% of the volume, and the opportunity to swap gas between different hubs. Otherwise hubs are private instruments."

#### OMV: Nabucco Addresses Europe's Infrastructure Problems

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¶21. (C) Moving to the issue of next steps, Nabucco MD Mitchek explained, "We need the first gas purchase agreement, and then the E&P environment in Azerbaijan and Turkmenistan will be encouraged. Infrastructure investments and gas storage in Turkey will also be encouraged." Auli pointed out that Romania, Bulgaria, and Serbia have national power grids, and argued that Nabucco will act as a highway connecting these. He also explained that Turkey suffers a gas bubble at certain times in the year (particularly in the summer), shortages at other times, and currently there is not the infrastructure to address these insufficiencies. He stated, "The EU 'third energy package' did not deliver sufficient incentives for investment, it's not a solution." Instead, the OMV team pointed to Nabucco as a way to resolve the many energy infrastructure issues confronting Europe.

#### OMV May Look to Brussels for Financial Guarantees

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¶22. (C) Revisiting the tariff issue with OMV, Senior Advisor Stein queried, "If Shah Deniz II is sanctioned, what is the maximum tariff for 16 bcm (in the 31 bcm Nabucco pipeline)? (Note: This is an issue of concern to SOCAR - see reftel. End note.) Auli sidestepped, and answered that if the tariff is too high, the consortium will need to approach

Brussels for a guarantee.

OMV Argues Nabucco Already Benefiting Region

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¶23. (C) Despite the steep cost for Nabucco, OMV argued some regional players are already seeing benefits from the project. Auli noted, "Turkmenistan has benefited from Nabucco already - they were earning \$80 a bcm (from the Russians), now they're earning \$200." Stein responded that the increased price probably had more to do with China's emergence as an alternative buyer. The OMV team also pointed out that Turkey is paying USD 1.5 billion this year to the Iranians in take or pay provisions. "One year of its take or pay payments would finance Turkey's portion of Nabucco!" Mitschek argued. He explained that Turkey could then use Nabucco as a route out if they have too much gas on hand.

OMV: IGA was Big Step for Turkey, but  
We have a Year to Wrap this up

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¶24. (C) Auli noted optimistically that Turkey had made a big move in signing a western-style IGA. Still, he pointed out, "We cannot wait 3 to 5 years, there are other projects." Mitschek contended, "We shouldn't try to solve all problems in the region with Nabucco. The business case isn't going to make neighbors trust each other. Therefore we should concentrate on the business rationale, which benefits the whole region." Senior Advisor Stein pointed out the need to manage around Armenia and Turkey rapprochement. Auli warned, "If Nabucco slows, we will lose it for 25 years....We can wait one year, the customers and the banks are not waiting. We have a tough time frame."

Comment

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¶25. (C) 26. (C) Both RWE and OMV agree that Nabucco has about a year to get off the ground. OMV may be overly optimistic on prospects for gas supply from Iraq solidifying within this year, but we concur with RWE that perhaps Turkmenistan gas may become viable - if only because there are fewer decisionmakers in Ashgabat. Nabucco remains an uphill battle, but if the number of key players in Baku this past week are any indication, for now, its private sector backers are happy to continue to commit planning resources to seeing it come to fruition. End comment.

¶26. This cable was cleared by Senior Advisor Dan Stein.

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